38. The recitals by these economists of the danger or likelihood of vertical squeezes and transfer of inputs among affiliates at discriminatorily favorable prices completely ignore the statutory requirements of imputation and the assurances provided to regulatory commissions by Professor Baumol himself—and us—of the sufficiency and efficacy of efficient component pricing rules in ensuring the ability of equally efficient competitors to survive and to prosper in competition with the ILECs.[11] The FCC has just reached the same conclusion:

> 275. *Price Squeeze Concerns Are Adequately Addressed.* Several parties have argued that current access charge rate levels create the conditions for an anticompetitive price squeeze when a LEC affiliate offers interexchange services in competition with IXCs....
>
> 278. We conclude that, although an incumbent LEC's control of exchange and exchange access facilities may give it the incentive and ability to engage in a price squeeze, we have in place adequate safeguards against such conduct....
>
> 279. The *Fifth Competitive Carrier Report and Order* separation requirements have been in place for over ten years, and independent (non-BOC) incumbent LECs have been providing in-region, interexchange services on a separated basis with no substantiated complaints of a price squeeze. Under these separation requirements, incumbent LECs are required to maintain separate books of account, permitting us to trace and document improper allocation of costs and/or assets between a LEC and its long-distance affiliate, as well as to detect discriminatory conduct. In addition, we prohibit joint ownership of facilities, which further reduces the risk of improper allocations of the costs of common facilities between the incumbent LEC and its interexchange affiliate....[T]he prohibition on jointly-owned facilities also helps to deter any discrimination in access to the LEC's transmission and switching facilities by requiring the affiliates to follow the same procedures as competing interexchange carriers to obtain access to those facilities. Finally, our requirement that incumbent LECs

[11] Professor Baumol and one of us both gave testimony, independently of one another, before the High Court of New Zealand in which both of us proclaimed the feasibility of efficient competition between a new entrant and a vertically integrated incumbent. We hasten to observe that some of the obstacles to that competition that Professor Baumol adduces in the present proceeding—such as possible discriminations by incumbent BOCs against their rivals in the quality of access and interconnection services—were not an issue in that proceeding. Our separate interventions were, however, both in support of the proposition that the prescription of what he termed the efficient component pricing rule and we referred to as the rules of competitive parity provide full protection against the application of price squeezes or predatory pricing. Our arguments were subsequently explicitly endorsed by the highest court of appeals, the British Privy Council.

> offer services at tariffed rates, or on the same basis as requesting carriers that have negotiated interconnection agreements pursuant to section 251 reduces the risk of a price squeeze to the extent that an affiliate's long-distance prices would have to exceed their costs for tariffed services....
>
> 281. Furthermore, even if a LEC were able to allocate improperly the costs of its affiliate's interexchange services, we conclude that it is unlikely that the LEC's interexchange affiliate could engage successfully in predation.[12]

39. Professor Baumol's assertion about the "heightened danger of monopoly profits stemming from the charges to competitors for access to essential network services" (pp. 6 and 19) simply ignores the fact that these essential network services have been and will continue to be subject to strict regulatory limitations, precisely in order to prevent monopoly profits.

40. The assertions by Professors Baumol and Hall that regulation will be defeated because of "cost misallocations between competitive and noncompetitive services" (Baumol, p. 21) and Professor Hall's raising of the danger that integrated LECs will shift costs from their competitive long-distance to their regulated operations (see pp. 53-54) ignore regulatory history in a way that can be described only as astounding. There is not the slightest recognition here of the fact that regulators have over the decades not only developed comprehensive methods of allocating costs, and controls over transactions among affiliates, designed explicitly to preclude such practices *but* have clearly—as AT&T has itself consistently maintained in the past—*been excessively effective* in "protecting" the basic residential charges from such "misallocations" (Baumol, pp. 21-22).[13] Indeed, some $20 billion a year of costs annually have been shifted *inefficiently* from regulated basic monopoly services *to* competitive services—services that

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[12] In the Matter of Access Charge Reform, CC Docket No. 96-262 et al., *First Report and Order*, Adopted. May 7, 1997, pars. 275, 278, 279, 281 (footnotes omitted).

[13] In our original submission, we cite the FCC's own recent conclusion that these accounting rules are fully sufficient to guard against threats to competition. (par. 46)

have become increasingly competitive *precisely because* of their regulatorily-dictated overpricing.

41. One such protection against cross-subsidization, now adopted in the majority of jurisdictions, is direct price regulation. We have consistently recognized that (as Professors Baumol, at pp. 24-25 and Hall, p. 54, contend) there are no pure price cap plans that completely and permanently sever any and all links between the regulated rates of monopoly services and the overall costs, revenues and financial fortunes of the ILECs. The fact remains that the FCC and a large majority of states have adopted this form of incentive regulation, precisely because at the very least it weakens those links and severely diminishes the likelihood of companies being able either to "shift costs" from competitive to monopoly operations, to cross-subsidize the latter at the expense of the former or to finance predatory tactics. Unsurprisingly, state regulators and Federal courts have recently ruled that price cap regulation can be an effective safeguard against cross-subsidization and other such anticompetitive behavior.[14]

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[14] [A] well designed price cap plan insulates ratepayers from investment risk and subsidization of new ventures. Massachusetts Department of Public Utilities, *NYNEX Price Cap*, D.P.U. 94-50 (May 12, 1995), p. 121.

A properly designed alternative regulation plan affords the opportunity not only for the Company to transition itself to a more competitive environment, but allows this Commission to implement safeguards and allocate risk in a fashion that protects the interests of all interested parties. Illinois Commerce Commission, 92-0448/93-0239 Consol. (October 11, 1994), p. 19.

We find attractive many aspects of a pure price cap model for establishing revenue levels ....The utility and its shareholders would be completely at risk for their operational decisions, and incentives to cross-subsidize more competitive activities with monopoly profits from basic services would be greatly reduced. California Public Service Commission, Decision 89-10-031, In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers (October 12, 1989), at 172-173

[T]he FCC has taken specific affirmative steps designed to deter and detect cross-subsidization by introducing price caps as well as further strengthening its cost accounting rules. We conclude that with the implementation of these measures, the FCC ... has demonstrated that the BOCs' incentive and ability to cross-subsidize will be significantly reduced. *California v. FCC*, No. 92-70083 and Consolidated Cases, 39 F.3d 919 (9^{th} Cir. 1994) ("California III") at 926-927.

(continued...)

42. One of Professor Hall's most surprising lines of argument. converting what an economist would ordinarily interpret as an enhancement of competition into an anti-competitive phenomenon, is his contention that letting ILECs into the interLATA business would in effect discourage or suppress competition at the local level. This would occur. he predicts, because the ILEC would ordinarily be expected to use its own local facilities to originate and terminate its long-distance calls and would have an incentive to reduce its "implicit access charges"—the only possible meaning of which is reduce its *toll* rates—"opportunistically to retain the access business." (p. 59) To this chain of reasoning there are the following answers:

- This assertedly discouraging effect on competitive opportunities for CLECs would occur only to the extent that the ILEC increases its share of the interLATA market from its present zero level: surely that would have to be regarded. at least in the first instance. as a reflection of successful competition.

- So Professor Hall here in effect converts a predicted *decrease* in toll prices (the only possible medium for his predicted decrease in the "implicit access charge") into an anti-competitive phenomenon without even claiming it would constitute successful predation. As we have already pointed out, so long as the ILEC is subject, as the Act requires, to the imputation rule, there is no way in which the effect could be anticompetitive.

- We may safely assume that AT&T. MCI *et al* will likewise prefer to rely, similarly, on their own local exchange and access services wherever feasible and/or on the access services of other CLECs. Both of these companies have announced plans to enter the local exchange business ubiquitously and this is precisely what the Act contemplates. To emphasize only the first tendency, the shift to the ILECs of some local exchange or access business that would otherwise go to independents, without mentioning the fact that it will be offset by the increased opportunity for more competitive challenges to the ILECs by the linkage of interLATA operations of the incumbent IXCs with CLEC activities of their own and others is to ignore the

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(...continued)

[Price cap regulation] reduces any BOC's ability to shift costs from unregulated to regulated activities, because the increase in costs for the regulated activity does not automatically cause an increase in the legal rate ceiling. *United States v. Western Elec. Co.*, 301 U.S. App. D.C. 268, 993 F.2d 1572 (D.C. Cir.), cert. Denied. 114 S. Ct. 487 (1993) at 1580.

> powerful phenomenon of competitive vertical integration. Hall obviously applauds the latter tendency while quarreling with the Act's entirely proper goal of symmetry.

43. If the ILECs were, by their entry into interLATA markets, effectively to eliminate market opportunities for independent LECs, it could be only if they achieved something like monopoly in those former markets. Yet Professor Hall nowhere dares explicitly to make such a totally improbable prediction. So he ends with a complete *reductio ad absurdum*: that the entry of SWB into the interLATA business, which his sponsor, MCI, so strenuously opposes, would not, in his interpretation, intensify competition but in the end produce "a reduction in competition in long-distance and higher prices to the long-distance consumer." If this is Professor Hall's belief, he should make the prediction explicit.

44. The FCC has clearly reached the opposite conclusion, as have we:

> 281. Furthermore, even if a LEC were able to allocate improperly the costs of its affiliate's interexchange services, we conclude that it is unlikely that the LEC's interexchange affiliate could engage successfully in predation. At least four interexchange carriers -- AT&T, MCI, Sprint, and LDDS WorldCom -- have nationwide, or near nationwide, network facilities that cover every LEC's region. These are large, well-established companies with millions of customers throughout the nation. It is unlikely, therefore, that one or more of these national companies can be driven from the market with a price squeeze, even if effectuated by several LECs simultaneously, whether acting together or independently. Even if it could be done, it is doubtful that the LECs' interexchange affiliates would later be able to raise, and profitably sustain, prices above competitive levels. As Professor Spulber has observed, "[e]ven in the unlikely event that [LECs' interexchange affiliates] could drive one of the three large interexchange carriers into bankruptcy, the fiber-optic transmission capacity of that carrier would remain intact, ready for another firm to buy the capacity at distress sale and immediately undercut the [affiliates'] noncompetitive prices. (Daniel F. Spulber, *Deregulating Telecommunications*, 12 Yale J. Reg. 25, 60, 1995)[15]

[15] *Op.cit.*, note 12, above, par. 281 (most footnotes omitted).

45. Indeed, and without apparently here recognizing any contradiction, Professor Hall asserts also that SWB is *not* likely to compete strenuously in the interLATA market and its entry would be unlikely substantially to benefit consumers. He bases this line of argument on a purported description of SWB's pricing policy in intraLATA markets, contending that it provides no support for the "proposition that it is a low-priced seller." (p. 61) Economists generally depend for their predictions of the behavior of businesses not on interpretations of their "personality" or predispositions but instead emphasize the determining role of objective market constraints to which they are or are not subject. The assertion that SWB has not been a vigorous price cutter in situations in which it has enjoyed a legal monopoly, even if true, tells us little about its likely behavior when it enters new markets with a zero share, in competition with firms dominating those markets.

46. Professor Hall makes no effort to reconcile his prediction that entry of the ILECs into the interLATA business will not bring purchasers of those services any benefit, in the form of reduced rates, with his prediction that they will, by lowering their "implicit access charges," deter entry and suppress competition at the local level. By the "implicit access charge," as we have previously pointed out, he can be referring only to the retail charges for interLATA service, the likelihood of SWB's cutting which he has previously denied. He cannot have the argument both ways—that entry by the ILECs into the interLATA business will not increase competitive pressures on the incumbent IXCs, by reducing retail charges, yet will impose competitive price pressures on CLECs via the "implicit access charge."

47. The testimonies of these several witnesses convert the conceded likelihood of economies of scope between local exchange and interexchange operations into an *unfair* advantage for the BOCs and therefore a threat to competition, because, assertedly, only the

ILECs can enjoy them (Hall, p. 55). This contention totally ignores the corresponding distinctive economies of scope that will be enjoyed by the other likely entrants—as Robert Allen, then CEO of AT&T proclaimed:

> For business customers, he said, AT&T could use the existing direct connections between AT&T switches and many of its business customers' offices to begin offering local services. Currently, a substantial number of the lines serving customers from AT&T's digital switching centers are directly connected to business customers' offices, Allen said.
>
> He added that once the law's requirements are met by the Bell companies, AT&T need only make software adjustments and establish links to local switches in order to allow these direct connections—now used only for long distance—to handle local traffic as well.[16]

48. Similarly, Professors Hubbard and Lehr cite the likely attachment by the BOCs of their brand names to their new interLATA services, "without payment," as constituting clear "cross-subsidization" (p. 61)—without any consideration of the *fact* that carriers like AT&T and MCI are using exactly the same strategy for their entry into intraLATA and local markets.[17]

49. In sum, what began in the rebuttal testimonies of Professors Hall and Hubbard and Lehr as a proffered statistical refutation of our contentions—along with those of other witnesses—that competition in the long-distance market has been highly imperfect and, in particular, failed

[16] "FORUM NEWS: ALLEN OUTLINES AT&T'S PLAN TO ENTER LOCAL TELEPHONE MARKET," February 8, 1996, p. 4.

[17] Their qualifying "without payment" raises a separate question, of which state regulators are fully aware, of whether the ILECs should be required somehow to reimburse purchasers of regulated services for the value of those brand names when attached to unregulated services. That issue in no way qualifies our observation that the marketing benefit to the RBOCs of using their familiar brands to market interLATA is no different—or necessarily greater—than the one enjoyed by the dominant long-distance carriers in entering local markets. (Incidentally, the case for reimbursing ratepayers on the ground that they have, arguably, contributed to the value of the BOC brand would seem to apply equally to AT&T.)

Similarly, Hubbard and Lehr say, p. 78, that the ILECs would unfairly have the unique ability to offer one-stop shopping, because of the absence of competitive offerings of local services: but that is why AT&T has been seeking the ability ubiquitously to resell basic local service. We fully recognized the need for symmetry in

(continued...)

in recent years to confer on small residential users even the full benefits of reductions in carrier access charges soon turned into a series of unsupported "opinions" and "judgments" that

- convert the opportunity requested by SWB to compete with incumbent oligopolists into an attempt at monopolization;
- convert the *likelihood* that SWB would offer reduced prices for interLATA services into an intention to engage in predation (Hubbard and Lehr, p. 53), while also
- *denying* that SWB is likely to be an aggressive price competitor;
- convert the rich history of regulatory cost allocations that have erred to the tune of $20 billion a year on the side of excessively "protecting" regulated services into a prediction of drooling incompetence on the part of utility commissioners to prevent cross-subsidization of competitive services at the expense of monopoly customers and monopoly pricing of essential inputs;
- by totally ignoring that history of regulatory *suppression* of basic local rates, conclude that the benefits of competitive entry into the local exchange business will be much greater than into the toll business because of the ILECs' monopoly and the greater inelasticity of demand for local services (Hubbard and Lehr, pp. 68-69) and so dismiss the WEFA projections on the ground that they fail to assume that local rates will fall as much as toll rates (p. 81);
- ignore a long history of AT&T witnesses proclaiming the sufficiency of the efficient component pricing rule to ensure fair competitive opportunity for equally efficient rivals;
- convert the efforts of the ILECs to recover their sunk costs or the costs of their obligations as carriers of last resort into a strategy "to directly or indirectly hinder the emergence of effective competition" (Hubbard and Lehr, p. 38).

C. The proffered anecdotal evidence is unconvincing.

50. Professors Hubbard and Lehr, Hall and Shapiro collectively provide a laundry list of complaints of assertedly anticompetitive tactics by RBOCs, evidently under the assumption that

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(...continued)

this respect in our original testimony. These witnesses simply ignore the status of negotiations to provide that symmetry for companies like AT&T and MCI.

where there is smoke there must be fire. Neither we nor they are in a position to evaluate each of these complaints. But differences of opinion, conflicts of interest and complaints are inevitable in negotiations of the kinds of arrangements between the ILECs and their competitors contemplated by the Act and necessary if there is to be efficient and effective competition.

51. It was precisely in recognition of the inevitability of such disagreements that Congress provided a procedure for the negotiations that it recognized would be necessary, for arbitration of differences and resolution by regulatory commissions, all under a tight time schedule. And the process is unquestionably working: to date, in Oklahoma alone, 48 companies have requested negotiations with SWBT and 18 of these companies (including Sprint) have successfully concluded negotiations without requests for mediation and without the need for arbitration. Of all the companies negotiating with SWBT in Oklahoma, AT&T has been the only one that has required the OCC to intervene through arbitration. This is a truly remarkable record of achievement.

52. In their unanimous protests that the local exchange business is monopolistic, the opposing witnesses systematically ignore or minimize the extent to which these arrangements, once in place, make those markets highly contestable— "a market condition that" Professor Baumol, one of the major and original protagonists of contestability theory, recognizes "offers public interest benefits virtually the same as those insured by powerful competitive forces." (p. 14)

53. Professor Baumol expresses the view, however, that "[e]ntry into many of the local exchange activities will hardly be quick and easy, as contestability requires." (*ibid.*) In our opinion, this summary observation fails adequately to take into account the fact that the

arrangements contemplated by the Act reduce the sunk investment costs of entry—which he identifies as the primary barrier to contestability (p. 16)—as close to the vanishing point as conceivable. This is the consequence, in particular, of the resale obligations imposed on the ILECs. If any would-be competitor has the right to purchase any and all of the incumbent's retail services at its retail prices less a discount determined by its regulators to be sufficient to enable an equally efficient retailer to compete, then *all* of the ILEC's retail markets are as close to perfectly contestable as conceivable. Rivals could at any time compete without having to sink a dollar into equipment that might not be fully retrievable if they decided to withdraw.

54. To be sure, that characterization may exaggerate the perfection of the consequent contestability of the local telephone markets. Presumably the challenging reseller would have to put in place some sort of interfaces to purchase services from the ILEC; it would have to make marketing contacts with customers and arrangements for billing them, some of which costs would be irretrievable upon its withdrawal from the market. (The notion of a competitive entrant having to be spared even the costs of contacting potential customers and billing them would reduce the concept of contestability to an absurdity. Moreover, billing could always be purchased as needed and therefore involve no sunk cost. They could contract out for marketing as well, under terms that, similarly, would make those costs avoidable. And in fact those incremental costs to a carrier such as AT&T or MCI, already covering virtually the entire interLATA market, of adding such consumer contacts for purposes of selling intraLATA and local services intraLATA as well—adding some lines to their advertisements and bills—must come as close to zero as can be conceived in the real world.) As the entry and continued existence of some five hundred resellers of long distance services attest, these barriers to entry and exit must be very low indeed.

55. What these successful arrangements accomplish is to give the IXCs the opportunity to offer consumers a full line of telecommunications services under their own brands and billing arrangements—the advantages of which are fully conceded by Professors Hubbard and Lehr—while denying that opportunity to the BOCs. The result is inevitably to distort the competition between them. Professor Hall denies that there need be any consequent loss of economies of scope: the efficiency of billing for local and long-distance service on a single bill, he points out, "could be achieved by contractual arrangements among non-competing entities"—as when a LEC bills for an unaffiliated IXC (p. 55). What he ignores is that under present arrangements the "non-competing" characterization applies to only one of the posited contracting parties, not the other: the BOCs, but not the IXCs (so long as they use unbundled elements and/or their own facilities rather than rely on pure resale) are prohibited from offering customers the one-stop shopping that so many of them concededly prefer.[18]

[18] In California, when the IXCs were permitted to carry intraLATA 800 traffic, Pacific Bell attempted similarly to introduce a service offering that allowed the customer to subscribe to Pacific's intraLATA product and an IXC's interLATA product. The arrangement proved to be highly unsatisfactory from Pacific's perspective. Both revenues and market shares plummeted precipitously. In late 1995, Pacific Bell reported to the FCC:

> Because it cannot offer 800 service with interLATA capability, Pacific Bell has already lost a substantial share of the business system market segment. Pacific Bell's share of intraLATA 800 minutes from 800 service has fallen by half over just the last four years, from 52 percent to 24 percent, in spite of Pacific's aggressive 800 pricing and marketing and overall growth in 800 minutes of 15 percent a year. Today, 800 services in California represent almost 9 billion minutes of use, and Pacific has a tiny 6 percent share. Comments of Pacific Bell and Nevada Bell, Before the Federal Communications Commission, Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, December 11, 1995.

IV. MISCELLANEOUS FACTUAL CRITICISMS

A. SNET's entry into interstate long-distance

56. Professor Hall as well as Ms. Banks have interpreted the experience in Connecticut since SNET began offering interLATA toll as indicative that interLATA entry by the RBOCs will confer few benefits on consumers and pose the threat of injury to competition. We disagree. Careful examination of the facts and allegations cited by these experts reveals that:

- SNET clearly undercut AT&T's basic rate, as we (relying on Crandall and Waverman) pointed out in our opening affidavit. Further, we understand that SNET has continued to compete vigorously on price and other dimensions. For example, it instituted six-second billing, which while not necessarily changing the tariff rates, clearly lowers prices to consumers. By properly accounting for factors such as the definition of peak and offpeak periods, calling patterns, and six-second billing, our colleagues at NERA inform us, SNET's prices are generally lower than under the major discount plans offered by other carriers, including MCI and Sprint.

- AT&T instituted its 5 cents per minute rate for intrastate calls after SNET's entry into interstate long-distance. Similarly, the new IXC discount rates cited by Ms. Banks and Professor Hall were introduced after SNET's entry. Thus, whatever the motivation for the subsequent pricing actions by the IXCs, Connecticut customers are clearly better off than before.

- Professor Hall cites the fact that SNET no longer bills for AT&T's calls as an example of noncooperative behavior. To the contrary, we understand that AT&T initiated the change in billing as part of a national policy to reclaim the billing function from the LECs.

B. Changes in Sprint's operations

57. Ms. Banks points out that some of our references to her client, Sprint, were factually incorrect. In particular, she criticizes us for (1) not recognizing that Sprint spun off its cellular operation to 360°, (2) claiming that its joint venture with cable TV companies (Sprint Spectrum) involves utilization of CATV infrastructure and (3) stating that Sprint's venture in the most recent spectrum auction included CATVs. Her observations are correct: we had not

updated some of our factual narrative for developments subsequent to the publication of the source documents we cited. In essence, however, these more recent developments essentially corroborate rather than contradict the basic point we were making: the boundaries between telecommunications markets are rapidly blurring and technological prospects constantly changing and firms are constantly forming and dissolving alliances and changing their plans in an attempt to accommodate to these developments.

58. Moreover, the changes in Sprint's structure and operations that Ms. Banks mentions have not altered the fundamental characteristics of firms like it. The cellular spin off, for example, does not mean that Sprint has abandoned vertical integration with wireless services. Rather, like Pacific Telesis (recently joined with Southwestern Bell) previously and US West recently, Sprint has evidently opted for the newer generation PCS as its main wireless platform. Similarly, while the emphasis of its joint venture with CATV companies might have changed, it is clear that (1) Sprint is still pursing a joint wireless/wireline strategy and (2) wireless technology itself can be a substitute for wireline, so that the Sprint wireless venture will be a player in both markets. Indeed, contrary to Ms. Banks' claim that the Sprint Spectrum partners have long since abandoned plans to offer local wireline services through upgraded facilities, the trade press recently reported that there would only be a limited delay: "Sprint ... probably won't rely on networks owned by Tele-Communications Inc., Comcast, and Cox Communications until the second wave of [PCS] rollouts scheduled to later this year."[19]

[19] Vince Vittore, "Sprint PCS Launches in 6 More Markets," *Cable World*, March 3, 1997.

V. REPLY TO PROFESSOR SCHWARTZ

59. Professor Marius Schwartz recommends that RBOC entry into long-distance be delayed until local markets are irreversibly open to competition (par. 19)—that is, until new access arrangements have been clearly demonstrated to be working (par. 182). While agreeing with us that RBOC entry into long-distance will be beneficial (par. 7) and that safeguards against anticompetitive behavior are adequate (par. 14), Professor Schwartz argues that local entry will occur more quickly if the carrot of interLATA entry continues to be withheld. And because he believes that the benefits from a more rapid introduction of local competition outweigh the sacrifice of admitted benefits from RBOC entry, he recommends a "modest delay" (par. 169) in granting Southwestern Bell's request.

60. Professor Schwartz also discusses how one would determine whether the local exchange has been irreversibly opened to competition. His preferred metric is the presence of competition (par. 20). In situations where rapid competitive entry was not economic, he would allow the RBOCs to rebut the presumption that their actions were responsible for the delay (par. 21). He appears to recognize that because incumbent IXCs can (and indeed are) entering local exchange markets, they would under his proposal gain a temporary advantage over the ILECs, but in his judgment the latter companies could quickly catch up (par. 164).

61. Professor Schwartz's proposals would impose a substantial burden on the ILECs beyond the requirements of the Telecommunications Act—in particular, the demonstration that competition has either started or been proven infeasible. Beyond the question of whether such an extra burden is legally permissible, we find them troubling for four reasons. First, Professor Schwartz has not demonstrated that the introduction of competition at the local level

necessarily requires it. Second, he ignores the fact that it would give the opponents of RBOC entry a powerful additional tool to delay it indefinitely. Third, he fails to consider the real possibility that actual RBOC entry into long-distance may itself *speed up* local entry. Finally, he provides no hard evidence to support his cost-benefit assessment.

62. The problem with imposing specific new requirements is that there is no proof that any new requirements are necessary additions to those imposed by the Telecommunications Act. One need look no further than Professor Schwartz's intraLATA toll example to see why specific requirements may not be necessary for competition to develop. Despite the fact that dialing parity has not been universally required, the IXCs have already captured 22 percent of that market nationwide (p. 11, see ftn 4). This amount of market share loss by incumbents is comparable to AT&T's in the interLATA market by 1988 (four years after divestiture) and is all the more remarkable in light of the fact that intraLATA toll competition was not even authorized in the two largest states, which account for 46 percent of all such calling (California and New Jersey), until 1995.

63. Just as Professor Schwartz' proposal is intended to extend the incentives of the RBOCs to cooperate in facilitating the entry of competitors, it gives the opponents of RBOC entry into interLATA markets new opportunities to use the regulatory process to delay that entry. We see no reason to alter the balance between these two incentives and opportunities established by the statute. Ascertaining whether entry has been "irreversibly established" would be extremely contentious. For example, the present filings of the economists representing the IXCs make it clear that they will argue—as some of them now do—that no amount of entry via resale, or even by purchase of unbundled elements, would be sufficient. The delays resulting from disputes of this type would prevent consumers from enjoying the benefit of RBOC entry that

Professor Schwartz acknowledges. In addition, the prospect of impeding RBOC entry by regulatory pleadings could provide incentives for the IXCs to pursue less vigorous local entry strategies themselves than they otherwise would, because vigorous local competition would hasten the day of the RBOC entry into competition with them that they obviously are exerting strenuous efforts to obstruct.

64. Conversely, and for the same reasons, actual entry by RBOCs into long distance service could well strengthen the IXCs' incentives to compete vigorously in the local market since it would withdraw the reward for delay. As artificial and asymmetrical restrictions are removed for everyone, performance in the marketplace, rather than success or failure in gaming the regulatory process, will and should determine which companies succeed or fail.

65. Perhaps most fundamentally, Professor Schwartz's conclusion that the benefits from delay outweigh the cost is speculative. Even ignoring the considerations we have adduced, which all tip the balance towards timely entry, he has provided no basis whatever for an objective assessment of the comparative benefits or losses to consumers from the projected effects of his proposal on price competition in the respective markets—positive and negative. Nor has he assessed the gains or losses of productive efficiencies from impeding the ILECs but not their competitors from engaging in unfettered competition. In contradiction of the basic rationale of the Telecommunication Act, which is to leave the outcome to the competitive market (subject to the antitrust-like protections incorporated in the Act), the rationale of his proposal is essentially *regulatory.* Rather than requiring regulators to satisfy themselves only that "the requisite *arrangements* necessary to open the local market are made available" (par. 70, stress supplied), as the statute stipulates, it would require them additionally to assess the degree to which that availability has *proved effective*—that is, whether "meaningful local

competition" has "emerged," and, if not, "why"—both complicated questions. (pars. 20, 80) This is clearly a rationalization for continuing micromanagement of a process that, he and we agree, Congress intended to deregulate.

VI. CONCLUSION

66. The standard of the public interest promulgated by the Telecommunications Act and supported by both the rebuttal witnesses and us is that the telecommunications markets are potentially competitive and that competition will produce results superior to those of regulation—and particularly of regulation that denies willing applicants the right to enter whatever markets they seek to serve.

67. We leave to others the exegesis of the legal implications of that determination by Congress. Its *economic* implication, however, is clear: entry can and should be denied willing competitors only in the presence of a strong likelihood that if permitted to enter they would *succeed* in weakening *competition* in that market as an effective discipline and protector of the public interest. We submit that such a danger in the case of entry by the RBOCs into the interLATA market is nonexistent: given the protections instituted by the Act and corresponding state regulatory policies, as well at the antitrust laws, we rate as absolute zero the possibility that by their entry into that market the RBOCs could do anything but intensify competition, to the benefit of the consuming public. We observe that nowhere can any of the witnesses in opposition bring themselves explicitly to predict that, entering those markets in competition with entrenched suppliers like AT&T, MCI and Sprint, the RBOCs could drive those firms out of the market or achieve a monopoly—or even so weaken their competitors as to produce a result less competitive than the market is now producing.

68. These last considerations pass over the fact that the Act seeks to encourage competition at the *local* level *for its own sake* and not merely to ensure fair competition in the interLATA market. It seeks to do so, however, by requiring the ILECs to *make available* to rivals the stipulated required tools. We agree with *that* requirement; it is Professor Schwartz's proposal of an additional hurdle that we reject.

Alfred E. Kahn

Subscribed and sworn before me this 20th day of May 1997

Notary Public

My commission expires July 31, 1997

MARY J. AUSTIC
Notary Public, State of New York
No. 01AU5046605
Qualified in Tompkins County
Commission Expires July 31, 19 97

Timothy J. Tardiff
Timothy J. Tardiff

Subscribed and sworn before me this 20th day of May 1997.

Christiana Olsen
Notary Public

My commission expires September 18, 2003

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554

In the matter of	)	
	)	
Application of SBC Communications Inc.,	)	
Southwestern Bell Telephone Company,	)	CC Docket No. 97-121
and Southwestern Bell Communications	)	
Services, Inc., for Provision of In-Region,	)	
InterLATA Services in Oklahoma		

REPLY AFFIDAVIT OF MICHAEL J. RAIMONDI

REBUTTAL COMMENTS ON THE ECONOMIC BENEFITS OF SBLD'S ENTRY IN INTERLATA LONG DISTANCE SERVICE IN OKLAHOMA

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I. INTRODUCTION

Several reports have been filed in CC Docket No. 97-121 on behalf of several inter-exchange carriers, namely AT&T, MCI, and Sprint, that question the underlying assumptions of my analysis of the economic benefits of SBLD's entry into the interLATA long distance markets in Oklahoma. This rebuttal addresses the issues raised for all three assumptions -- the price assumption, the information services productivity assumption, and the labor force participation assumption. It reiterates that the assumptions used to simulate the change are both realistic and reasonable. Based upon the assumptions used in the testimony, Oklahoma gains an additional 10,252 jobs and $712 million in real gross state product over the next 10 years relative to the Baseline forecast. However, even if the assumptions are believed to be optimistic by some parties -- and in my opinion they are already conservative -- the magnitudes of the assumptions could be reduced and still yield a substantial benefit to the Oklahoma economy. For example, reducing all of the assumptions by fifty percent would still improve the economy, adding nearly 5,000 new jobs and nearly $350 million in real gross state product over the next 10 years relative to the Baseline forecast.

II. PRICE ASSUMPTION

The assumed competitive price reduction in the Long Distance simulation is 5% per year for the first five years of the analysis. This is an average reduction across all long distance rates. Some users receive greater reductions than others depending on the prices they are currently paying and the volume that they generate. Others receive less. It is also important to note that the 5% per year reduction is relative to the Baseline forecast which incorporates a slight decline in long distance rates over the entire ten year forecast period. This being the case, the Baseline projection of a slight price decrease over the forecast interval is not a simple extrapolation of the historical trend for the Consumer Price Index for long distance services. That is because the model and the analysis are not based on the CPI version of price change for long distance services. Finally, in the Long Distance simulation, there are no additional long distance service price reductions relative to the Baseline forecast assumed after the first five years of the forecast. The long distance price trend reverts back to the Baseline forecast after the first five years. Thus, the pattern of the price assumption does account for the expected increase in competitive activity as another major player (i.e. SBLD) enters the markets in Oklahoma, and the subsequent stabilization after the excessive profit has been wrung out of the system.

The magnitude of the price reduction relative to the Baseline forecast is certainly reasonable. Besides the observed examples of price reductions when a local exchange carrier has entered the interLATA market in a few areas of the United States, the significant discrepancy between prices and costs provides considerable room for prices to decline. Considering the current access fee cost of 5 to 6 cents per minute and incremental costs of 1 to 2 cents per minute, the long distance margin is currently very large. First, if you believe that basic long distance rates of approximately 20 cents per minute for the major interexchange carriers represent their average prices, then a margin of approximately 60% exists at this time. Second, if you believe average revenue per minute of approximately 15 cents per minute received by the major inter-exchange carriers represents their average price, then a margin of approximately 40% to 50% exists at this time. In either case, the margin is quite large, and an additional major competitor would result in lower prices. Thus, current prices contain enough margin to generate at least a 25% average price reduction over five years as assumed in the Long Distance simulation. In reality, prices will probably fall that much or more in a shorter period of time.

Furthermore, the largest component of the cost -- access fees -- fell 6.6% on average per minute during 1996 alone and fell 7.9% on average per year since 1986 as represented by MCI's data. In a competitive market, the prices being charged for the service would tend to follow costs downward. With the entry of SBLD into the interLATA markets in Oklahoma, I believe the increase in competition will create an environment in which prices will quickly move closer to the cost of providing the service and continue to follow costs throughout the forecast period.

II. INFORMATION SERVICE PRODUCTIVITY ASSUMPTION

In the Long Distance simulation, productivity in the use of information services is increased 2% per year in the first five years of the forecast interval relative to the Baseline forecast, due to the entry of SBLD into the interLATA long distance markets in Oklahoma. This adjustment is intended to represent the favorable impacts that lower long distance prices and improved technologies will bring to their usage throughout the business community and in households. In the context of increased competition in interLATA long